No. 88-192

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

MCKESSON CORPORATION,

Petitioner,

v.

DIVISION OF ALCOHOLIC BEVERAGES AND TOBACCO, DEPARTMENT OF BUSINESS REGULATION, and OFFICE OF THE COMPTROLLER, STATE OF FLORIDA,

Respondents.

On Writ of Certiorari to the Supreme Court of Florida

BRIEF OF GEORGIA, LOUISIANA, MARYLAND, MICHIGAN, MISSISSIPPI, NEBRASKA, NEVADA, NEW HAMPSHIRE, NEW JERSEY, NORTH CAROLINA, OKLAHOMA, OREGON, SOUTH CAROLINA, SOUTH DAKOTA, TENNESSEE, UTAH, VERMONT, VIRGIN ISLANDS, VIRGINIA, WISCONSIN, AND WYOMING AS AMICI CURIAE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Amici curiae will address only the first question set forth in the Court's July 3, 1989 order:

> When a taxpayer pays under protest a state tax found to violate clearly established law under the Commerce Clause must the State provide some form of retrospective relief, such as a tax refund or an offsetting tax on past beneficiaries of the tax preference, or may the State elect to provide only prospective relief?

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INTEREST OF AMICI CURIAE

This brief in support of Florida is submitted on behalf of Georgia, Louisiana, Maryland, Michigan, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Vermont, the Virgin Islands, Virginia, Wisconsin and Wyoming pursuant to Supreme Court Rule 36.4.

In its July 3, 1989 order, the Court asked for additional briefs and argument in *McKesson* on the following issue:[1]

> When a taxpayer pays under protest a state tax found to violate clearly established law under the Commerce Clause must the State provide some form of retrospective relief, such as a tax refund or an offsetting tax on past beneficiaries of the tax preference, or may the State elect to provide only prospective relief?

109 S. Ct. 3238 (1989).

After argument in *McKesson* on March 22, 1989, the Court decided *Davis v. Michigan Department of Treasury*, 109 S.Ct. 1500 (1989). In *Davis*, the Court held that Michigan's taxation of federal retirement benefits, while exempting state and local retirement benefits, violated the constitutional doctrine of intergovernmental tax immunity as embodied in 4 U.S.C. § 111. 109 S.Ct. at 1508.

The effect of the decision in *Davis* was not only to question the validity of the income tax structure in at least twenty-three states but also to raise the issue of under what circumstances states must refund taxes previously paid. This latter issue was not addressed in *Davis* since respondent State of Michigan had conceded that a refund was due if the tax exemption was declared invalid. 109 S.Ct. at 1508-09. Accordingly, there is a potential that states affected by the *Davis* decision could be substantially affected by the decision and rationale in *McKesson*.

Additionally, amici states and other states are from time to time faced with litigation which challenges state taxes on Commerce Clause grounds. Amici states, therefore, have a direct and abiding interest in the refund issue now before this Court on reargument in *McKesson*.

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[1] This amici curiae brief will not address the second issue scheduled for reargument in *McKesson* regarding whether a State may remedy the effect of a discriminatory tax by retroactively raising the tax on those who benefitted from the discrimination. 109 S.Ct. 3238 (1989).

SUMMARY OF ARGUMENT

The extent of the potential financial impact on the states which may be affected by *Davis* accentuates the importance of allowing individual state legislatures and courts to determine the issue of when state tax refunds are required. *See* Appendix A for a list of the states potentially affected by the decision in *Davis*. Each state has provided information on the potential financial impact on that state if it is required to refund for its current statutory refund period the taxes previously paid on federal retirement benefits.[2]

Should the Court determine that, under the facts presented in *McKesson*, federal law requires refunds, amici curiae respectfully submit that the Court should narrowly confine this remedy to the *McKesson* facts: the payment under protest of a tax that violates clearly established law under the Commerce Clause.

ARGUMENT

I. *Determination of Payment of Refunds Should Be Left to Individual States*

Assuming that the decision in *Davis* invalidates the tax structure in approximately twenty-three states, each of these states must decide whether to amend its tax statutes to extend the exemption to federal retirees or to repeal the exemption for state and local retirees.[3] This Court appropriately recognized in *Davis* that this decision should be left to the state legislatures and state courts and not to the federal courts. The Court stated:

> In this case, appellant's claim could be resolved either by extending the tax exemption to retired federal, employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. The latter approach, of course, could be construed as the direct imposition of a state tax, a remedy beyond the power of a federal court. . . . The permissibility of either approach, moreover, depends in part on the severability of a portion of [the tax statute granting the exemption] from the remainder of the Michigan Income Tax Act, a question of state law within the special expertise of the Michigan courts. . . . It follows that the Michigan courts are in the best position to determine how to comply with the mandate of equal treatment.

109 S. Ct. at 1509.

In *McKesson*, the state legislature has already determined that the manner in which that state will comply with the constitutional mandate of *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), is by eliminating the preferential tax treatment given to local products. The question of whether and how refunds should be made also should be determined by the state legislatures and state courts in accordance with principles of state law. Two factors support the appropriateness of such a ruling: (1) the complexity of the taxing structure at the state level and (2) a recognition that any holding requiring tax refunds could have a severe economic impact upon states other than the one before the Court.

Prospective and retrospective remedies are interwoven in tax cases. When a state tax statute is held unconstitutional, the state's decision concerning prospective and retrospective relief will be based to a great extent upon a balancing of the effect, together and separately, of both forms of remedy on the taxpayers and on the state. In determining the manner in which it will provide *prospective* relief, a state's decision to extend an exemption to one class or to repeal an exemption for another will depend upon that particular state's ability to accommodate an unexpected decrease in future revenues within its budget. A federal mandate of *retroactive* relief requiring the refund of taxes paid over a period of years may have an even greater financial impact on the state than a prospective remedy. Together, the impact could be devastating. A state may be confronted simultaneously with a loss of anticipated future revenues, the loss of reserves retained from past revenues, and the need to use current revenues to repay taxpayers for funds previously collected, budgeted or spent. Clearly, a state will be unable to determine its future course if it lacks control over past and current revenues. A decision that federal law mandates tax refunds from a state treasury removes from each state the critical ability to direct its financial future.

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[2] Appendix A has been compiled solely to illustrate the extent of the potential impact on the states of refunds under *Davis*. It neither represents nor implies that any state listed has, in fact, any liability for refunds under *Davis*.

[3] By late July 1989, at least twelve states had enacted legislation to alter the state income taxation of public employee retirement benefits: Arizona, Colorado, Iowa, Missouri, New York, North Dakota, Oklahoma, Oregon, South Carolina, Virginia, West Virginia, Wisconsin. *See* 54 *Tax Administrators News* 73 (July 1989).

The full impact of such a holding cannot be predicted.[4] Even the possibility, however, that revenues collected under a presumptively constitutional state tax statute could, at some future point, be subject to refund by a federal rule established by this Court would pose a constant threat of disruption by the federal government of a state's fiscal planning. Such entanglement of the federal courts in state financial matters clearly is contrary to "the fundamental principle of comity between federal courts and state governments, . . . particularly in the area of state taxation." *Fair Assessment in Real Estate Ass'n v. McNary*, 454 U.S. 100, 103 (1981). This principle is reflected in a long history of Court decisions and in the Tax Injunction Act itself, 28 U.S.C. § 1341. *See Tully V. Griffin, Inc.*, 429 U.S. 68, 73 (1976) (The Tax Injunction Act "has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operation."). *See also California v. Grace Brethren Church*, 457 U.S. 393, 410 n. 23 (1982) ("This Court has long recognized the dangers inherent in disrupting the administration of state tax systems."); *Rosewell v. La Salle Nat'l Bank*, 450 U.S. 503, 522 (1981) (imperative need of a State to administer its own fiscal operation was principal motivating force behind Tax Injunction Act).

Both the practical dangers inherent in a federal rule dictating the circumstances under which refunds must be paid from a state treasury and the strong federal policy favoring comity between federal courts and state governments support a decision protecting a state's tax system from unnecessary federal intervention. The Court should rely on the sound judgment, sense of fairness, and the ability of state legislatures and state courts to carefully tailor the appropriate circumstances for refunding state taxes. Perceived errors in the exercise of this judgment can be corrected through the taxpayers' use of the electoral process and through the economic pressures which can be exerted by both in-state and out-of-state interests.

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[4] A holding in a tax case often affects a large class of similarly situated taxpayers. The Virginia Department of Taxation estimates that Virginia alone has approximately 200,000 federal retirees, any or all of whom may argue that they are entitled to refunds of taxes paid prior to the amendment of the state's tax structure at a Special Session of Virginia's General Assembly called in response to this Court's decision in *Davis*. Source (for number of federal retirees): U.S. Dep't of Defense, *FY 1988 DOD Statistical Report on the Military Retirement System* 21 (1988); U.S. Office of Personnel Management, *Compensation Report: U.S. Civil Service Retirement System; Federal Employees Health Benefits Program; Federal Employees' Group Life Insurance Program; Pay Programs*, Exh. R13 (1985).

II. *If the Court Should Create a Federal Rule Mandating Refunds, the Court Should Narrowly Confine Such Ruling to the McKesson Facts*

Amici curiae support the argument of the respondents that when a state tax statute is found to be unconstitutional, a state may limit the relief to prospective relief only. If the Court determines, however, that federal law mandates refunds in *McKesson*, it should narrowly confine its holding to the facts presented in that case. Such a holding would require that (1) the taxpayer must pay under protest,[5] (2) the tax must be found to violate clearly established law, and (3) the tax must violate the Commerce Clause.

The reasons for these conditions are several. First, if the tax violates clearly established law and if the taxpayer pays under protest, the state could be considered to have been put on notice that its revenues may not be secure from claims for refunds under the questioned statute. With such notice, the state could reasonably plan its use of revenue sources. Moreover, a statute found to violate the Commerce Clause arguably may affect out-of-state interests not always represented in the state legislature through the electoral process, which may justify an exception to the federal courts' general policy of non-intervention in a state's administration of its tax system.

In contrast, a state is justified in relying on a tax that taxpayers have paid voluntarily without protest and that does not violate clearly established law. Under these circumstances, the state has had no notice either from the taxpayer or from the courts that its statute may be unconstitutional and, thus, no reason to make emergency plans. Also, in contrast to taxpayers affected by Commerce Clause violations, taxpayers subject to state individual income taxation, such as the individual retirees in the states affected by *Davis*, are represented in the state legislature, and the special protection of the federal courts is unwarranted.

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[5] Amici curiae interpret the protest standard as a threshold requirement establishing that the state was on notice, not only regarding the constitutionality of one of its taxing statutes but also regarding the extent of any refunds that may be claimed. As such, retrospective relief would be available only to taxpayers who meet the payment-under-protest standard and only for the time period during which the taxpayer paid under protest. Further, the protest necessary to justify the possibility of retroactive relief for any taxpayer would be a type of protest that clearly puts the state on notice of a constitutional invalidity challenge and the possibility of refund. The filing of an amended return or other procedural form alone would not constitute such notice.

CONCLUSION

For the reasons stated, this Court should leave to the states the fashioning of an appropriate remedy when a taxation statute is declared unconstitutional. Alternatively, if the Court determines that federal law mandates retrospective relief in *McKesson*, such a decision should be narrowly drawn to apply only to a tax paid under protest and found to violate the Commerce Clause under clearly established law.

Respectfully submitted,

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APPENDIX A
FISCAL IMPACT OF DAVIS

State	Potential Refund Liability Under State Statute of Limitations Period[1]
Alabama	$10.2 million
Arizona	$261 million[2]
Arkansas	$28 million
Colorado	$22.2 million
Georgia	$200 to $250 million
Iowa	$30 to $50 million
Kansas	$50 million
Kentucky	$50 million
Louisiana	$21 million
Michigan	$25 million
Mississippi	$30 to $35 million
Missouri	$152 million
Montana	$15 million
New Mexico	$25 million
New York	$35 million
North Carolina	$140 million[3]
Oklahoma	$87 million
Oregon	$150 to $190 million
South Carolina	$200 million
Utah	$80 to $100 million
Virginia	$370.4 million
West Virginia	$27 million
Wisconsin	$103 million
TOTAL:	$2.1 to $2.25 billion

[1] All amounts are estimates, provided by each state's department of revenue or taxation or office of its Attorney General in response to a telephone survey conducted by the Virginia Office of the Attorney General.

[2] Under a State superior court order setting forth a formula to determine refunds, the State's potential liability may be substantially less than this figure.

[3] Amount alleged by federal retirees to be in controversy in presently pending class action suit.